

CHAPTER 11

THE ROLE OF THE AUDITOR IN CONTRACT LITIGATION

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CHAPTER 11

THE ROLE OF THE AUDITOR IN CONTRACT LITIGATION

I. INTRODUCTION.

- A. Attacking contract claims often requires a team approach, which may include the services of “forensic accountants,” cost and price analysts, work process experts, cost modelers, criminal investigators, and auditors. Because of the government’s extensive audit rights, the data that will be central to any such team’s analysis may be in the auditor’s possession before the attack begins.
- B. However, obtaining this evidence, maximizing its effectiveness, and minimizing the potential pitfalls that doing so entails require a keen appreciation for the auditor and his world.

II. WHAT IS AN AUDIT?

- A. Generally, “the independent examination of financial information of any entity . . . when such an examination is conducted with a view to expressing an opinion thereon.” “Codification of Statements on Audit Standards,” AICPA (1986).
 - 1. However, “[t]here is no commonly accepted definition of precisely what constitutes an audit . . . [I]n order to be understood, the term “audit” must be accompanied by an explanation of (1) the auditing standards followed, and (2) . . . the purpose and scope of work undertaken.” Generally, the term is “used to refer to a variety of types of examinations and reviews by a person other than the preparer of the data.” Defense Contract Audit Agency, DCAA Contract Audit Manual (CAM)¶ 2-001.

2. Contract audit: an investigation, performed by one or more individuals who have special expertise in financial analysis, to determine whether the amount sought by the plaintiff accurately states the damages suffered by the plaintiff. See R. Nash, Jr. & S. Schooner, The Government Contracts Reference Book 36-37 (1992); Defense Contract Audit Agency, DCAA Contract Audit Manual ¶ 1-104.2a; 10-210.3 (“Scope of Audit”).
3. Typically, such audits will include an examination of a contractor’s books and records, the copying of pertinent data (in hard copy or electronic form), and discussion of those records with company personnel.
4. Audits may be financial audits or performance audits, which must be distinguished from other limited auditor engagements, known as “reviews” or “agreed-upon procedures.” E.g., CAM 9-108

III. DOD AUDIT ORGANIZATIONS.

- A. Generally, DOD audit organizations can be divided into those that conduct “internal audits,” “internal reviews,” and “contract audits.” DOD Directive 7600.2. See also CAM ¶ 2-104 (referring to types of government audits as financial, financial-related, economy and efficiency, and program).
- B. Internal audits assist DOD management by analyzing procedures, control, and performance of existing organizations and programs. E.g., AAA, AFAA, NAS.
- C. Internal review organizations belong to DOD components, and assist local commanders to resolve problem areas, by evaluating operations and controls, and supplement the audit services.
- D. Contract auditors review contract records and provide independent audit services to DOD procurement and administration officials.
 1. Normally, internal audit and review organizations obtain contract information from DCAA, but may perform the work themselves when DCAA cannot do so within “mutually acceptable” timeframes. DOD IG may inspect contractor records without DCAA assistance.

2. DOD IG performs “audits of the entire procurement process, including those that evaluate the performance of contractors and DOD procurement and contract administration officials.”
 3. Practice Hint: Always inquire whether contract program has been the subject of an IG investigation.
- E. Significant assistance is also available through private damages experts.

IV. DOD’S PRINCIPAL CONTRACT AUDITOR: DCAA.

- A. Established 1965, consolidating the contract audit functions, previously performed by each military service.
- B. Charter - DOD Directive 5105.36 (Feb. 28, 2002); CAM ¶ 1-102 (5105.36 is reprinted, starting at page 104).
- C. “Perform all necessary contract audit for the Department of Defense and provide accounting and financial advisory services regarding contracts and subcontracts to all Department of Defense components responsible for procurement and contract administrations. These services will be provided in connection with negotiation, administration, and settlement of contracts and subcontracts.” DOD 5105.36 para. 3 (emphasis added).
 1. These include price proposals; preaward surveys; forward pricing; labor and overhead rates; acceptability of incurred costs/overhead rates; TINA compliance; CAS compliance; claims; contractor internal control systems audits; adequacy of contractor accounting and financial management systems, estimating procedures and property controls.
 2. Practice Hint: DCAA performs “advisory services.” Thus, DCAA assistance is not limited to standard audits and may extend to reviews and other agreed-upon procedures relating to government contracts, and concerning accounting, financial, and audit expertise. CAM 1-407.

3. Practice Hint: For each contractor subject to government audit rights, DCAA establishes schedules designed to perform all required audits, reviews, and evaluations, such as floor checks and estimating system reviews. Many are not dependent upon any particular contracts. Thus, the Resident Offices, in particular, are gold mines of information and are experts in the contractor's books and records.

D. Organization.

1. Independent Agency under control of USD (Comptroller) organized into a HQ, 5 subordinate regions, and including 300 Field Audit Offices and 4,000 people (3451 auditors).
2. Field Audit Offices include:
 - a. Resident FAOs
 - b. Branch FAOs
3. General audit policy guidance is responsibility of DOD IG. DOD Directive 7600.2.

V. HOW DCAA CAN HELP.

- A. DCAA will provide litigation audit support that “fully respond[s] to the needs of counsel.” CAM ¶ 1-407. This support can include “comprehensive audit and accounting advisory services; accounting research applicable to the specific case, including testimony relative to the audit report; or testimony as an expert on accounting and auditing practices and procedures.” Id.; see also id. ¶¶ 15-503 c., 15-505.2, 15-505.3, 15-505.4, 15-506, 15-507; DODD 7600.2 (“Audit Policies”)(February 2, 1991).
- B. DoD audit organization shall provide appropriate audit support when such support is required by DoD investigative agencies. CAM 1-406

- C. Detection of fraud is addressed in CAM Chapter 4, Section 7.
- D. Examples of use of auditor to assess claim:
1. Obtain Documents;
 2. Determine total cost incurred (by discrete cost group, if possible);
 3. Determine whether costs claimed are supported by source documents and whether accounting systems yield competent evidence of those costs;
 4. Determine whether the costs claimed have been correctly allocated/charged to the contract/claim;
 5. Determine whether the costs claimed are allowable, pursuant to FAR § 31.205, DFARS § 231.205 (if applicable), and the provisions of the contract;
 6. Determine whether overhead rates were properly computed or whether they include costs ALSO charged as direct thus leading to double recovery;
 7. Determine any increase in overhead rates that is beyond the control of the government;
 8. Determine any increase in costs attributable to cost escalation that is beyond the control of the government;
 9. Determine the total amount paid by and to the claimant;
 10. Review estimates for accuracy of application of methodology and costs used;

11. Determine defects in performance measurement systems and cost and schedule controls that might result in overstatement of inefficiencies allegedly caused by government or explain why those inefficiencies occurred see CAM 11-300);
 12. Review previous reports of Unsatisfactory Conditions or indicators of fraud;
 13. Identify methods for accurate segregation of costs foregone by contractor in its attempt to justify use of total cost method.
- E. Review Contractor Compliance with Suspension and Debarment Agreements (CAM ¶ 4-711)

VI. SCOPE OF AUDIT.

- A. Department of Defense Directive No. 5105.36, “Defense Contract Audit Agency,” ¶ D.3 (June 8, 1978) (as updated by Change 1, March 17, 1983) (“DOD Directive 5105.36”), states that DCAA is to conduct audits and review and examine contractor and subcontractor “accounts, records, documents, and other evidence . . . to the extent and in whatever manner is considered necessary to permit proper performance” of DCAA’s functions. Id., ¶ D.3.
1. Comment: It is difficult to imagine a broader delegation of discretion.

- B. Department of Defense Instruction No. 7640.4, “Department of Defense Contract Auditing Standards,” (“DOD Instruction 7640.4”), “establishes auditing standards that shall be followed by DoD contract audit organizations and auditors.” Id., ¶ A. Enclosure 1, “General Auditing Standards For DOD Contract Audit Organizations,” (Sep. 4, 1986) to DOD Instruction 7640.4, states that the auditor is responsible for determining the “[e]xtent of audit work needed to achieve audit objectives.” Enclosure 1, ¶ B.1.e. (1). Under the heading “Independence,” Enclosure 1 states that an auditor must have “complete freedom to make an independent and objective judgment” and that the audit will be “adversely affected” if this freedom is impinged, which can occur if others have authority to “override or to unduly influence the auditor’s judgment as to selection of what is to be audited, [or] determination of the scope or approach of the audit” Enclosure 1, ¶ A.2. Such impingement also occurs if a party other than the auditor “[i]nterfere[s] with access to records, reports, audits, reviews, documents, papers, recommendations, or other material needed to carry out the audit or denies the auditor the opportunity to obtain explanations from officials and employees.” Enclosure 1, ¶ A.2.e. See also id. ¶¶ A.3, A.5, B.1, B.2.f, C.2, D.4.a-c.
- C. Department of Defense Directive No. 7600.2, “Audit Policies,” ¶ F.15.b.(1) (March 20, 2004) states that “Audit organizations should have full and unrestricted access to all personnel, facilities, records, reports, databases, documents, or other DoD information or material in accomplishing an announced audit objective when requested by an auditor with proper security clearances.”
- D. DCAA Contract Audit Manual (“auditors must obtain sufficient competent evidential matter . . . through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.” CAM at ¶ 4.2c.

VII. THE AUDITOR’S ENVIRONMENT - AUDIT STANDARDS.

- A. Introduction.
 - 1. Auditing standards include general professional and specific criteria that must be observed by auditors and understood by litigation attorneys at the risk of losing whatever evidentiary or conclusive value an audit might have.

B. Sources.

1. GAO, which establishes generally accepted government auditing standards (“GAGAS”), which are set forth in “Governmental Auditing Standards” (aka The Yellow Book).
2. The American Institute of Certified Public Accountants (AICPA), a voluntary nationwide organization for the establishment of auditing standards, performed this function until 1973.
 - a. Its industry audit guide and ethics interpretations, published as the “Codification of Statements on Auditing Standards,” still influence government accounting. See SCM Corporation v. United States, 645 F.2d 893 (Ct. Cl. 1981); DOD Instruction 7640.4. These standards are known as Generally Accepted Accounting Standards (GAAS).
 - b. AICPA also publishes audit guides. Of special interest is the “Guide for Audits of Federal Government Contractors”(May 1996).
3. OMB - the executive agency responsible for establishing accounting and audit standards for government through OMB Circulars.
4. The Government Accounting Standards Board (GASB) - since 1984, the arm of the Financial Accounting Foundation with responsibility for establishing financial management policy, including budgeting, accounting, reporting, and auditing for federal agencies and organizations that receive federal assistance.
5. The Federal Accounting Standards Board (FASB) - the arm of the Financial Accounting Foundation (a nonprofit foundation) with responsibility for promulgating uniform accounting and auditing standards for private and, to a large degree, public sectors.
6. DOD Regulations and Manuals.

- a. DOD Directive 7600.2 (“Audit Policies”).
- b. DOD Instruction 7640.4 (“DOD Contract Auditing Standards”).
- c. The CAM (provides “technical audit guidance, audit techniques, audit standards, and technical policies and procedures to be followed by DCAA personnel in the execution of the contract audit mission”).
- d. DCAA Standard Audit Programs.
- e. DCAA Memorandums for Regional Directors (MRD).
- f. These are publicly available at www.dcaa.mil.

(1) It was not always so. See Fenster v. Brown, 617 F.2d 740 (D.C. Cir. 1979) (DCAA audit manual discoverable under FOIA)

C. Practice Hint: These rules are so specific as to be a gold mine for an attorney examining a DOD auditor -- either for lack of compliance or lack of knowledge

VIII. PARTICULAR STANDARDS OF INTEREST TO ATTORNEYS.

A. General Standards.

1. Qualifications (CAM § 2-202).

- a. These involve training and experience and, like all standards, should be scrutinized by the litigation attorney because they present fodder for cross-examination.

- b. Audits vary in purpose and scope. Some require an opinion on the adequacy of financial representations; others an opinion on the adequacy of financial representations; others an opinion on compliance with specific laws, contractual provisions, and other requirements; others require reviews of efficiency and economy of operations; and still others require some of all of these elements. CAM § 2-202 (a). The effectiveness of contract audits is governed in large measure by the caliber and training of the person or persons performing the work. The auditor is expected to have acquired through continuing education, training and experience the ability to plan, to devise and apply effective audit procedures; to determine facts; to make reasonable judgments and decisions; and to prepare objective and effective reports. The continuing education and training may include such topics as current developments in audit methods, accounting, assessment of internal controls, principles of management and supervision, financial management, statistical sampling, evaluation design, and data analysis. It may also include subjects related to the auditor's field of work, such as public administration, public policy and structure, industrial engineering, economics, social sciences, and computer science.

2. Independence (CAM § 2-203).

- a. "the audit organization and the individual auditors . . . should be free from personal and external impairments to independence, should be organizationally independent, and should maintain an independent attitude and appearance" (the three impairments).
- b. Personal impairments include:
 - (1) personal relationships;
 - (2) preconceived ideas toward audited group or program;
 - (3) subsequent performance audit by the same individual who approved previous claims or proposed payments;

(4) financial interest.

c. External impairments include:

(1) interference in the scope and character of the audit;

(2) denial of access to sources such as books records, and supporting documents or officials and employees of the organization under audit;

(3) interference in the assignment of personnel to the audit task;

(4) unreasonable restrictions on the time allowed to competently complete and audit.

d. Organizational impairment:

(1) refers to idea that auditor can be influenced by place in organizational structure;

(2) to achieve maximum independence, auditors and their organizations should report to the highest echelon within their government component and be organizationally independent.

3. Due Professional Care (CAM § 2-204).

a. “[M]eans . . . using sound professional judgment in establishing the scope, selecting the methods, and choosing tests and procedures for the audit . . . also requires supervisors to look critically at the work done.”

- b. See General Dynamics v. U.S., 1996 WL 200255 (C.D. Ca 1986), rev'd, 139 F.3d 1280 (9th Cir. 1997) (DCAA subject to professional standards, including those promulgated by AICPA; audit conclusion negligently breached that standard, leading DOJ to win indictment and, later withdraw it based upon that negligence). Reversal was on ground that indictment was nonactionable due to FTCA's prosecutorial discretion exception.

4. Quality Control (CAM § 2-205).

- a. Organizations conducting IAW these standards should have an external QC review at least once every three years by an organization not affiliated with the organization being reviewed – to determine whether the organization's internal quality control system is in place and operating effectively. For DCAA, provided by DODIG.

B. Field Work Standards (CAM §2-3 and 2-5) - slightly different for financial audits and performance audits - contract audits include elements of both.

- 1. Generally, includes requirements of planning, audit follow-up, supervision, procedures to understand control environment, assessing risk and determining audit tests, and work papers.
- 2. Sufficiency Standard. Auditor must collect sufficient competent and relevant evidence to afford a reasonable basis for the auditor's findings. CAM § 2-306 and 2-506).
 - a. Evidence may be physical, documentary, testimonial or analytical.
 - b. Methods of collection include observation, measurement, questionnaires, and structured interviews.

- c. Practice Hint. Audits undertaken pursuant to these standards may yield evidence necessary for a fraud investigation. However, if interviews are conducted pursuant to a litigation attorney's specific request (vice the auditor's own determination) and are done without a KTOR's agreement and notice to counsel (if the KTOR is a represented party), they present the possibility of an ethical violation.
- d. Whether evidence is "is competent" is determined by "presumptions" concerning the quality of evidence. For example, evidence from a credible third party is more valuable than that obtained from the auditee. Yellow Book at ¶ 6.53.

3. Working Papers.

- a. See AICPA "Audit and Accounting Manual"; GAO "Standards for Audit"; CAM § 2-305 and 4-400.
- b. Working papers contain the audit program and tests performed; memoranda, notes, and letters that are material and relevant to the audit (including, potentially, letters from attorneys), the conclusion reached; and the analysis and information (abstract or copy) upon which conclusions were reached.
- c. Working papers must be understandable w/o supplementary oral explanations; must contain evidence that supervisory reviews were conducted; and must contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's significant conclusions and judgments.
- d. Practice Hint. If the working papers do not meet this standard, the auditor is vulnerable as a witness. Thus, the responsible attorney MUST review the working papers — and expect the KTOR's attorneys will too.

- e. SCM Corporation, 645 F.2d 893. (Ct. Cl. 1981) (discussing professional standards requiring government auditors to retain working papers to substantiate their conclusions and rejecting KTOR attempt to prohibit DCAA from taking copies of business sensitive documents for the audit file).

C. Reporting Standards (CAM 2-400 and 2-600).

- 1. Attorney must be aware of these because they set out required findings and distribution.

IX. YOUR RELATIONSHIP WITH THE AUDITOR.

A. Ultimately, the attorney is responsible for the conduct of the investigation.

- 1. See General Dynamics v. U.S., 1996 WL 200255 (C.D. Ca 1986), rev'd. 139 F.3d 1280 (9th Cir. 1997).
 - a. “Prosecutors are understandably enticed by the lure of the big fish. But when the unsubstantiated indictment can lead to the imposition of over \$25,000,00 in attorney’s fees on an innocent party . . . we should hope for — nay, we expect — more responsible conduct by the government . . . It conducted an investigation . . . which was either unconscionably inadequate at best or recklessly arrogant at worst.” Id. at 1287 (Judge O’Scanlan, dissenting).
- 2. Qualifications - understand the auditor may be a witness and, therefore, may require special attributes

B. Control/Independence.

- 1. DCAA will provide litigation audit support that “fully respond[s] to the needs of counsel.” CAM ¶ 1-407.

2. DoD audit organization shall provide appropriate audit support when such support is required by DoD investigative agencies. CAM 1-406 (emphasis added).
3. BUT, Auditor may not issued unqualified opinion unless “able to apply all the procedures considered necessary in the circumstance.” DOD Instruction 7640.4 (Encl. 1 at 1-10); see CAM ¶¶ 2-203.
4. Nonetheless, you may specify the following without running afoul of auditor independence issues. In both cases, the auditor should qualify his analysis accordingly – and you must be willing to provide any such specifications to the contractor.
 - a. The auditor should accept your legal opinion and report of your technical experts, where the auditor requires a legal or technical opinion.
 - b. In performing quantification analysis, the auditor should assume the contractor will prevail on questions of liability. Nonetheless, the auditor should bring any questions regarding liability to your attention, inasmuch as there might be a secondary “liability” issue your general instruction was not intended to cover.
5. You may ask the auditor to conduct “specified procedures,” i.e., a particularly-focused examination, if: (1) you do not require a full claim audit (i.e., one in which auditor judgment and standard audit programs would determine the scope of work), or (2) you want the audit to be supplemented in some way.
 - a. E.g., you may require only an opinion concerning the allowability of certain costs.

- b. Or, you may wish the auditor to perform a total cost analysis with regard to specified elements of the work. You might do so to ensure that, for costs attributable to a certain aspect of the work, the claim does not seek more than the total amount incurred in performing that aspect of the work. (The auditor might do this anyway).
- c. Your specification of such a procedure (which should never be finalized without consulting with the auditor to ensure you are not unwisely cramping the investigation) will become a part of the auditor's report.

C. Shared Territory - Consultation & Explanation.

- 1. Some areas are highly technical and, ordinarily, would not be grounds for disagreement, e.g., sufficiency of accounting system, reliability of results, incurred cost. Others, however, are more judgmental, e.g., allowability, degree of testing, and scope of audit.
- 2. Generally, audit standards require auditor and supervisors to carefully and logically weigh evidence - moreover, auditor is an expert. Thus, disagreements concerning what the evidence means should be carefully explored and legal elements of proof should be explained to the auditor. Also remind auditor that decisions made during this audit are not necessarily a reflection upon previous audits, which may have considered the same or similar evidence for a different purpose or at a different depth.
- 3. In the end, if you disagree, you disagree. Auditor's conclusions do not bind agency. Hydrothermal Energy Corp. v. United States, 26 Cl. Ct. 1091, 1103, n.24 (1992) (DCAA's acceptance of contractor-proposed rate court did not bind agency). Delco Electronics Corp. v. United States, 17 Cl. Ct. 302, 313, 323 (1989), aff'd, 909 F.2d 1495 (Fed. Cir. 1990). But, what if you don't like result? Auditor's verification of accuracy of damages does not establish government liability. Joseph Pickard's Sons Co. v. United States, 209 Ct. Cl. 643, 647, 532 F.2d 739 (1976); Boyajian v. United States, 191 Ct. Cl. 233, 247, 423 F.2d 1231 (1970).

4. Consult auditor when investigative agent presents case with audit aspects, especially if based upon DCAA referral.

X. MISC. ISSUES IN WORKING WITH AUDITORS.

A. Who Owns The Work Papers.

1. Generally, the auditor does, unless specified in engagement. See, e.g., CAM ¶ 1-407 (“While DCAA may maintain custody of any documents developed while providing support to the trial attorney, control over the documents rests with the trial attorney or his/her successor.”) The CAM further specifies that DCAA will “[a]rrange to have all pertinent working papers at the hearing.” CAM ¶ 15-506.5).
2. Be careful what you say, it may wind up in working papers and be discovered. This should be discussed with auditor. Note distinction in CAM between “administrative” working papers and audit working papers. CAM § 4-403.

B. Attorney-Client Privilege/Attorney Work-Product Doctrine.

1. The ACP covers statements made to attorneys for the purpose of obtaining legal advice. The WPD is designed to protect mental impressions recorded in anticipation of litigation. In engaging DCAA, the object is to obtain their testimony, touting their independence. Thus, in order to be effective, the auditor’s work should be transparent, and not shrouded in secrecy or affected by undisclosed advice or opinions.
 - a. See CAM 4-304.7 (“Litigation Support”)(auditor should ask if audit will be privileged and, therefore, should not be divulged to auditee).

2. Beware that, arguably, statements made by a client in front of the auditor waive the ACP or are otherwise disclosable as matters reviewed by the auditor in reaching an expert opinion. You might argue that the auditor is an extension of your advice-giving and, therefore, statements made in front of him were made with an expectation of confidentiality and not waived; but, consider the effect that has upon your claim of auditor independence. Perhaps result is different if auditor acts solely as a litigation consultant, and not a testifying witness.
 - a. Ordinarily, you will plan to have auditor testify and should expect to produce the audit work papers.
3. KTOR forfeiture of privilege - Disclosure of “one document” to DCAA may waive privilege, depending upon circuit. E.g. In re Sealed Case, 877 F.2d 976, 980 (D.C. Cir. 1989)(court “will grant no greater protection to those who assert the privilege than their own precautions warrant.”). United States v. Massachusetts Institute of Technology, 129 F.3d 681 (1st Cir. 1987) (disclosure of documents to DCAA was a “voluntary” disclosure and, therefore waived privilege in subsequent IRS enforcement action).
- C. Requesting draft audits before auditor “goes final.” See Roebbelen Engineering, Inc., DOT BCA Nos. 1591 et al., 87-3 BCA ¶ 20,163 at 102,055-56 (1987).
- D. “Flying Under False Colors.”
 1. Auditor, especially, one working in a Resident Office and, therefore, one, who must maintain a close working relationship with contractor personnel, may be reluctant to investigate fraud under guise of conducting routine business.
- E. Reporting of Audit findings to Auditee.
 1. Ordinarily required, but DCAA will not disclose if will compromise investigation.

- F. Be sure to call opposing counsel to coordinate the audit, to ensure you do not run afoul of ethics rules concerning contact with represented persons.
- G. Summary. The auditor is a professional who can be a significant resource, but is subject to professional and practical limitations that must be understood in order to maximize the auditor's effectiveness.

XI. THE GOVERNMENT'S AUDIT RIGHTS.

A. Statutory Audit Rights.

- 1. 10 U.S.C. § 2313, Examination of Books and Records of Contractor, subparagraph (a), establishes authority for agencies to examine the books and records of contractors and subcontractors performing cost or cost-plus-fixed-fee contracts or any subcontract under such contracts. FAR clause 52.215-2, Audit—Negotiation, subparagraph (b), Examination of costs, implements this provision.
- 2. 10 U.S.C. § 2313(d) (non-testimonial subpoena power)
 - a. Permits DCAA to subpoena all records “related to the negotiation, administration, or settlement of cost-type contracts” where necessary to evaluate accuracy, completeness, and currency of cost or pricing data.
 - b. Subpoena not limited to “materials actually submitted or relied upon” by contractor in calculating claimed costs. Newport News Shipbuilding v. U.S., 862 F.2d 464 (4th Cir. 1988)(remanding), aff’d, 900 F.2d 257 (Table) (1990) (federal tax returns and correspondence proper subject); but see Newport News Shipbuilding v. U.S., 8837 F.2d 162 (4th Cir. 1988)(“subjective evaluations” (internal audits) not proper subject); but see Director, Office of Thrift Supervision v. Ernst and Young, 786 F.Supp. 46 (D.D.C. 1992)(questioning 4th Circuit’s subjective distinction).

3. 10 U.S.C. 2306a (TINA) Cost or Pricing Data: Truth in Negotiations, subparagraph (g), entitled Right of United States to Examine Contractor Records, establishes authority for agencies to examine and audit all records of a contractor or subcontractor for the purpose of evaluating the accuracy, completeness, and currency of any cost or pricing data required to be submitted to the government. FAR clause 52.215-2, Audit—Negotiation, subparagraph (c), Cost or pricing data, implements this provision.
 - a. Records include: contractor and subcontractor proposals, discussions conducted on the proposal, pricing; and performance. See Newport News Shipbuilding v. U.S., 862 F.2d 464 (4th Cir. 1988) (remanding), aff'd, 900 F.2d 257 (Table) (1990) (legislative history supports right of government access to records to verify costs charged to government).
4. 41 U.S.C. § 422(k), Examinations. Determination of whether a contractor has complied with applicable Cost Accounting Standards (CAS) (FAR Part 30, 4 C.F.R., Subchapter G), and consistently followed contractor's disclosed cost accounting practices.
5. 18 U.S.C. § 1516 (felony to influence, obstruct, or impede an auditor with intent to deceive or defraud the United States); CAM ¶ 4-708.

B. IG Subpoena Power.

1. Proper for DCAA to request IG to issue subpoena pursuant to 5 U.S.C. App. § 6(a)(4), and IG may do so as long as IG did so “in furtherance of a purpose within his statutory authority and exercised some independent judgment” in deciding to do so. United States v. Westinghouse, 788 F.2d 164 (3rd Cir. 1986) (holding that internal records not directly related to government contract were relevant because in paying indirect costs DOD pays for all programs and they indicate how vigilant Westinghouse is in combating fraud).

C. Contract Clauses (check for inclusion in contract at issue).

1. FAR § 52.215-2, “Audit—Negotiation” (Dec 1989), requires contractors to maintain “books, records, documents, and other evidence and accounting procedures and practices, regardless of form . . . or type . . . sufficient to reflect properly all costs claimed to have been incurred . . . in performing this contract.” See also 48 C.F.R. § 52.214-26, “Audit-Sealed Bidding” (Apr 1985).
 - a. Includes software and electronic media. FAR § 52.215-2(a).
 - b. Note: the clause does not define what constitutes an audit, or specify the contractor’s support obligations.
2. FAR 52.215-2(a). Government may “examine and audit” these records “at all reasonable times.” See also 48 C.F.R. § 52.214-26, “Audit-Sealed Bidding” (Apr 1985).
3. FAR 52.215-2(d). Contractor must maintain these records for “examination, audit, or reproduction,” and must do so until:
 - a. “3 years after final payment” (id.); or
 - b. “until such appeals, litigation, or claims are disposed of.” Id. at 52.215-2(d)(2).
4. If contractor must submit cost or pricing data, government may examine “all books, records, documents and other data of the Contractor (including computations and projections) related to negotiating, pricing, or performing the contract”; but, not limited to cost or pricing data alone, rather to “all documents necessary to permit adequate evaluation.” FAR 52.215-2(b).
5. See Jana, Inc. v. U.S., 936 F.2d 1265 (Fed. Cir. 1991) (failure to retain = failure to prove = government right to reclaim overpayment).

D. Discovery.

1. Rule 34, “Production of Documents and Things . . .” provides that a party must “produce and permit the party making the request, or someone acting on the requestor’s behalf, to inspect and copy, any designated documents (including writings . . . , and other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form) . . . which constitute or contain matters within the scope of Rule 26(b) and which are in the possession, custody, or control of the party upon whom the request is served” FRCP 34(a).

2. Rule 33, “Interrogatories to Parties,” states that “[w]here the answer to an interrogatory may be derived or ascertained from the business records of the party upon whom the interrogatory has been served or from an examination, audit, or inspection of such business records, including a compilation, abstract, or summary thereof, and the burden of deriving or ascertaining the answer is substantially the same for the party serving the interrogatory as for the party served, it is a sufficient answer to such interrogatory to specify the records from which the answer may be derived or ascertained and to afford the party serving the interrogatory reasonable opportunity to examine, audit, or inspect such records and to make copies, compilations, abstracts, or summaries.” FRCP 33 (emphasis added).

3. Sufficient to support a claim audit?
 - a. In Aerospatiale Helicopter Corp., DOT BCA Nos. 1905 et al., 89-3 BCA ¶ 21,897 at 110,154 (1989), the board denied a motion to dismiss, but stated that “dismissal with prejudice . . . may be appropriate in the future if the appellant fails to comply with our . . . Order to produce the documents for audit.”

 - b. In TDC Management Corp., DOT BCA No. 1802, 88-1 BCA ¶ 20,242 at 102,470 (1987), the board stated in dicta that if a contractor refused to cooperate with an audit being performed as part of discovery, “such refusal could constitute a valid basis for a suspension of proceedings until the refusal is remedied, and if the refusal continues could be cause for an outright dismissal of the claim”

E. Court Order.

1. Courts have broad discretion to regulate the discovery and presentation of evidence. E.g., Roberts v. United States, 174 Ct. Cl. 940, 949 (claim element disallowed because “plaintiff neglected to comply with pretrial instructions relative to production of supporting data for pretrial verification”).
2. E.g., Standard Order of Court of Federal Claims Judges Merow and Bush, requiring plaintiffs to submit:
 - a. “schedule(s) or summary(ies) setting forth all items and figures, from books of account or other records, and any calculations or estimates derived therefrom, which are to be introduced in evidence such as will permit their pretrial verification by examination or audit or also serve to obviate the introduction into evidence of voluminous original materials.”
 - b. A statement regarding each schedule describing the “sources for the items or figures listed (ledgers, journals, payrolls, invoiced, checks, time cards, etc.); their “location(s) . . . time when the source(s) may be examined or audited by the opposing party, the name and address of the person(s) who prepared each schedule or summary and who will be made available to the opposing party during any examination or audit of the source material to provide information and explanation required for verification of the listed items or figures.”
 - c. See also ASBCA “Order on Proof of Costs.”
3. Thus, on motion or sua sponte, a court could order an audit, or order that a claimant assemble its quantum data in a specific order and form, and provide all supporting data to the court or the government. The ensuing product should lend itself to ready audit or analysis.

F. Regarding a court’s expression of support for audits, generally, see:

1. Coastal Industries, Inc. v. United States, 32 Fed. Cl. 368, 377 (1994) (“The court places significant weight on the detailed audits of the DCAA”); Youngdale & Sons Construction Co. v. United States, 27 Fed. Cl. 516, 554-60 (1993); North Slope Technical Limited, Inc. v. United States, 14 Cl. Ct. 242, 264-68 (1988); Neal & Company, Inc. v. United States, 17 Cl. Ct. 511, 514 (1989), (“an audit is a useful tool at trial in gauging the sufficiency of a claimant’s proof”).

G. Regarding helpfulness of auditor testimony, see:

1. Hydrothermal Energy Corp. v. United States, 26 Cl. Ct. 1091, 1096 (1992) (court rejected testimony by plaintiff’s expert because it “was disputed by the government auditor”). Skip Kirchorfer, Inc. v. United States, 14 Cl. Ct. 594, 609 (1988) (court accorded “great weight” to testimony by DCAA auditor). Coastal Industries, Inc. v. United States, 32 Fed. Cl. 368, 377 (1994) (“the DCAA confirmed some elements of Coastal’s claims”); Youngdale & Sons Construction Co. v. United States, 27 Fed. Cl. 516, 554-56 (1993) (“If it were not for this concession, verified in the defendant’s audit report (DX 50), the plaintiff would have failed to carry its burden, by a preponderance of evidence, with respect to its alleged damages”) .

XII. ISSUES CONCERNING THE CONDUCT OF THE AUDIT DURING LITIGATION

A. May government conduct audits during litigation to develop its litigation position? Yes, but some contractors will fight the idea anyway.

1. See section XXI D-E, above (court’s direct involvement under discovery and trial management powers).

2. SCM Corp. v. United States, 645 F.2d 893 (Ct. Cl. 1981) - (claim denial affirmed for failure to cooperate); Panama Power & Light Co. v. United States, 150 Ct. Cl. 290, 299-301 (1960) (costs disallowed for failure to supply supporting records); Shelly's of Delaware, Inc., ASBCA No. 37404, 90-2 BCA ¶ 22,690 at 113,690 (contractor must "comply with all of the material and relevant administrative burdens imposed by the terms of the contract, regulations and statutes"); American Business Systems, GSBCA Nos.5140, 5141, 80-2 BCA ¶ 14,460 at 71,291-93 (T4D affirmed); Grumman Aircraft Engineering Corp., ASBCA No. 10309, 66-2 BCA ¶ 5846 at 27,143-44 (following Panama Power & Light, but explaining that "disallowance must bear some reasonable relation to the maximum dollar amount which could be equated to the failure to disclose . . . [and amounts should be allowed] as to which other books and records of a contractor showed it to be clearly entitled").

B. Mode and Extent of Documentation Examined -- Auditor's discretion. May involve more than just allowing auditors to inspect books, may include interviews with company employees and removing copies.

1. SCM Corp. v. United States, 645 F.2d 893 (Ct. Cl. 1981) (court affirmed ASBCA decision that denied the contractor any recovery on a claim when the contractor, which had generally cooperated, prevented the auditors from removing copies of documents and information that the contractor considered proprietary, such as the names of its vendors. DCAA refused to audit under these circumstances. Analysis was premised upon requirements of "generally accepted accounting standards," which requires auditors to document their findings).

2. ASBCA - Grumman Aircraft Engineering Corp., ASBCA No. 10309, 66-2 BCA ¶ 5846 at 27,143-44 (1966) (“The appellant, in essence, is responding that it will decide how much the Government auditor needs to see and which of the documents in its files are pertinent and proper for the auditor's perusal. At the same time the Government agrees to pay a contractor's costs of contract performance, it also reserves the right to satisfy itself with reasonable certainty what those costs truly are When . . . a contractor enters into a contract in which the Government agrees essentially to pay him what it costs him to perform, that contractor has also invited the Government into his office to determine what those costs are. Thereafter, a Government auditor looks over his shoulder. The marriage of Government auditor and contractor is not easily dissoluble. That auditor certainly has no right to roam without restriction through all the contractor's business documents which have no connection with the Government contract. But he has to satisfy himself as to items claimed to be part of the costs of performing the Government contract. When the claim is as to an overhead or indirect cost, there may be some necessity to look at entries other than those for labor, material, and equipment used directly in the performance of the Government contract. We conceive of the audit function, when it applies, as a broad rather than a narrow one.” Accord Hayes International Corp., ASBCA No. 18447, 75-1 BCA ¶ 11,076 at 52,730 (1975) (right to audit included right to examine contractor's “books of account,” not just document contractor submitted for payment).
3. Other - Inslaw, Inc., DOT BCA Nos. 1609 et al., 89-1 BCA ¶ 21,238 at 107,118 (1988) (“in conducting an audit, auditors may need to make inquiries as to how books and records are maintained . . . requiring contractor to accommodate auditors for extended periods”); Accord Aerospatiale Helicopter Corp., DOT BCA Nos. 1905 et al., 89-1 BCA ¶ 21,559 at 108,575-76, 108,580-81 (1989) (board rejected argument that audit should be performed by an entity mutually acceptable to the parties, and not by DCAA, explaining that the contractor “yielded that right when [it] executed the contract,” and that the government had the right to unilaterally select the entity that would perform the audit); American Business Systems, GSBCA Nos. 5140, 5141, 80-2 BCA ¶ 14,460 at 71,291.

- C. Timing. Contractor may pay lip service to audit rights, but schedule and limit its support so as to prioritize formal discovery – with hopes of delaying completion of the audit until it is too late to use its results at trial. Get the court involved to coordinate and schedule discovery and audit tasks.
- D. Updating of Claim – contractor may update a claim when doing so does not transform it to a new claim requiring a new COFD. In litigation, contractors frequently update claims, so you must ask at the outset about the contractor’s plans in this regard, and involve the court if necessary to prevent wasted audit work, and to ensure there is time for a meaningful audit of the claim to be tried.
- E. Requests for bifurcation – because audits are a “follow the money” investigative technique that often uncover a story contrary to that presented in the claim, do not agree to bifurcation unless: (1) the parties agree – or the court/board orders – that the audit will go forward before trial; or (2) it is clear that no such investigation is necessary (for example when issues are strictly legal).
- F. Time spent responding to DCAA auditors recoverable. Penberthy Electromelt International, Inc. v. United States, 11 Cl. Ct. 307, 327 (1986).

XIII. KTOR USE OF DCAA AS SHIELD/SWORD.

- A. TINA.
 - 1. Making documents available to DCAA does not satisfy TINA disclosure. Lockheed Aircraft Corp. v. U.S., 193 Ct. Cl. 86 (1970). Accord Motorola v. West, 125 F.3d 1470 (Fed. Cir. 1997)(simply making books available does not constitute “submission” of cost or pricing data). But see Martin Marietta Corporation, ASBCA No. 48,223, 98-1 BCA ¶ 29,592 (subcontractor alleged overstatement of G&A rate did not entitle government to reduction in price because sub’s quarterly submission to actual G&A rates to same auditor who performed preaward audit constituted an adequate TINA disclosure).
- B. FOIA.

1. Original compilation of documents by DCAA during routine audit does not bar their later being characterized as a “compilation for law enforcement purposes ” and, therefore, withheld from disclosure, when turned over to law enforcement. John Doe Agency v. John Doe Corp., 493 U.S. 146 (1989).
 2. Draft report of audit of HUD loan sales program protected by deliberative process privilege. Hamilton Securities Group, Inc. v. HUD, 106 F.Supp.2d 23 (D.D.C. 2000).
- C. “If DCAA never caught it, how could we?”
1. “An audit made in accordance with [GAGAS] will not guarantee the discovery of illegal acts or contingent liabilities resulting from them. Nor does the subsequent discovery of illegal acts committed during the audit period necessarily mean that the auditors’ performance was inadequate” GAO Yellow Book ¶ 4.16 at 37.
 2. Due to DCAA staffing levels, transaction testing is limited.
- D. Voluntary Disclosure (See CAM 4-707).
1. Required responses to DCAA audit questions that disclosed wrongdoing did not constitute voluntary disclosure. United States v. Rockwell, 924 F.2d 928 (9th Cir. 1991).
- E. Statute of Limitations
1. Boeing, Inc. et al. v. U.S., 845 F.2d 476 (4th Cir. 1988)(report of ethical misconduct to DCAA (not later report to KO) triggered statute of limitations because DCAA has responsibility to act on reports of misconduct).

2. Jana, Inc. v. United States, No. 94-203C (August 19, 1998, Fed. Cl.)(unpub'd.) (DCAA suspected irregularity report did not trigger fraud counterclaim SOL because report was labeled “suspected,” it pertained to only one delivery order (and, therefore, was not sufficient to “create a concrete suspicion of a fraudulent mischarging scheme”), and DOJ audit request instructed DCAA to “assume that Jana’s time and accounting records . . . were accurate and had not been fraudulently altered.”

XIV. OTHER RESOURCES - PRIVATE CONSULTANTS.

- A. Cost considerations - who pays? (DOD components “shall not contract for audit services” except in limited circumstances. DOD 7600.2 F.14.)
- B. Teaming claims consultants with DCAA.
 1. Example. Attacking disruption or total cost claim.
 - a. Methodology - Strip back these non government-responsible costs from the total cost:
 - (1) escalation costs; unallowables (using DCAA); unanticipated overhead allocation to government contract because of decrease of other business (using DCAA); contractor responsible costs; disruption associated with contractor responsible costs; delay.
 - (2) Apportion contract growth into cost accounts and time periods to determine whether cost growth matches contractor’s claim story.

XV. CONCLUSION.